

Feb. 19, 1992

LETTER 1089

THE PICTURE: In view of today's flagrantly overvalued market, there's one question that's constantly on my mind. The question: "Is the bull still firmly in command, or is the primary trend of the market close to, or in the process of, turning down?"

And the answer, based on current evidence, is that the bull is still in command. Bulls on the market can rely on the time-honored Dow Theory thesis which states, "*A trend, once in force, continues in force until PROVED otherwise.*" And as of this writing, despite an 18-year bull market, despite extreme overvaluation, despite intense, almost frantic speculation, despite massive public participation, we have no proof that the bull has given up the game.

Bears on the market can warn that no previous bull market has ever withstood a Dow yield of 2.82% (or a S&P 500 yield of 2.91%) without running into major trouble.

Actually, there are two ways of looking at this market. One is strictly from the standpoint of market action. In other words, is the market "behaving" all right, are the averages in gear on the upside, is breadth moving up, is my Primary Trend Index still in a bullish mode?

The other way of looking at this market is from the historical standpoint of values, and, of course, this approach is considerably fuzzier as to timing. For the value investor, the critical question is always whether the market is in an historical buy zone or a sell zone, and if so, what to do about it.

From the "market action" standpoint, since the prevailing trend has been bullish, we must give the bull position every benefit of the doubt. That doesn't mean, however, that we should fly blind. As this is written (although it may have changed by the time you receive this Letter) there are a number of important non-confirmations.

The Dow high was struck on February 12 at 3276.83. But this record high was a solo affair in that it was not confirmed by the Transportation Average, the Utility Average, the NYSE Composite or the S&P 500. The Transports recorded their high of 1445.81 on January 16. The NYSE hit its high of 231.85 on January 15. The S&P 500 struck its high of 420.77 on January 15. Finally, the Utility Average recorded its high back on December 31 at 226.15. So watch all these averages to see whether they confirm the Dow or whether they continue to resist upside confirmation.

On the positive side, my **Primary Trend Index** has advanced into new high ground as has the very important advance-decline ratio (see page 2 chart). I want to say a bit more about my Primary Trend Index. The PTI is strictly concerned with market action. It doesn't care about public sentiment, puts or calls, short interest, stock yields, or length and duration of a bull or bear market. What the PTI does tell us at any given time is whether the underlying pressure in the market is to the upside or the downside.

I've often stated that one method of investing is to blindly follow my PTI. If the PTI is bullish you buy stocks and sit with those stocks. If the PTI is bearish, you're out of the stock market and in cash. Anyone can follow the PTI -- all you have to know is up from down. I grade the PTI in the simplest way possible -- and 21 years of history tells me that my system works. If the PTI is decisively above its 89-day moving average, I grade it bullish; if

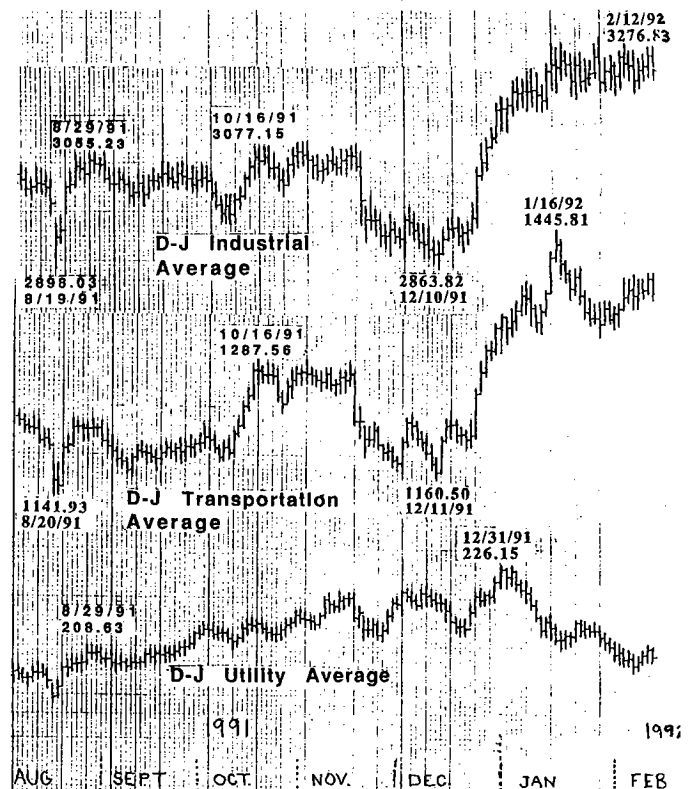
Feb. 7 DJIA 3225.40; PTI 3456; A-D Ratio -8.91
Feb. 13 DJIA 3246.64; PTI 3465; A-D Ratio -8.67
Dow Yield: 2.85%; Dow P/E: 52.8; DowPow: 192
Dow 200-day MA: 3018; Dow 30-day MA: 3168
Dow Times Book Value: 2.43; PTI 89-day MA: 3418
Percentage of Undervalued Blue-chips: 8%

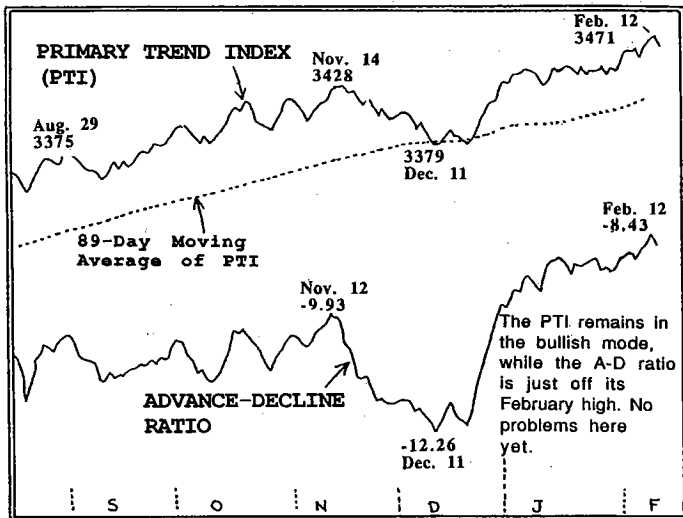
the PTI is decisively below its 89-day moving average I grade it bearish. Currently, as you can see on the page 2 chart, the PTI is bullish. It's been in the bullish mode ever since February 1991. Last week, in fact, the PTI advanced to a new record high.

Next question -- **tactics and strategies**. For those who trade or invest strictly on the action of the PTI, you're holding stocks as you have been for the last year. But what about the value investor or the newcomer who hasn't committed to anything yet? Personally, I feel that a market in which the Dow yields 2.82% is not a market you're going to make money in. Very simply, history tells us that stocks bought in this kind of super-low yielding market are far more likely to provide losses than gains.

VALUES: What are your odds of winning if you buy stocks today at these prices? *Market Logic* (3471 N. Federal, Ft. Lauderdale, FL 33306) does a good deal of outstanding research, and this is what they found. Referring to the S&P 500, *Market Logic* checked the record based on (1) price/earnings ratios and (2) yields -- both in relation to the prevailing T-bill rate:

P/E	Future 1-Year Market Change With ...	
	T-Bills Under 4%	T-Bills Above 4%
Under 8	+21%	+26%
8-12	+17%	+ 8%
12-16	+12%	+ 8%
16-20	+ 9%	0%
Over 20	→ (- 9%)	-15%





Today the S&P 500 sells at a P/E ratio of 23 while yielding 2.96%. At the same time, the rate on 91-day T-bills is 3.91%. Referring to the chart, on the basis of the current S&P P/E ratio and the current T-bill yield, one year from now the S&P would be **down 9%**.

On the basis of the current S&P yield in relation to the yield on the T-bills, a year from now the S&P would be **down 2%**. Those are obviously not good odds, but as every bull is probably telling himself, "This time it's different." Let's hope so.

Yield	Future 1-Year Market Change With ...	
	T-Bills Under 4%	T-Bills Above 4%
Over 5%	+15%	+17%
4-5%	+15%	+10%
3-4%	+11%	+ 5%
Under 3%	→ (- 2%)	-12%

My friends at *Growth Fund Research* (Box 6600, Rapid City, SD 57709) have also published a fascinating study based on the Price/Dividend ratio for the S&P 500 (i.e., price of the S&P 500 divided by its dividends). *GFR* notes that at the recent January 15, 1992, high the P/D ratio for the S&P was **34.89**. The ratio has only been that high seven times before in history -- in September 1929, July 1933, November 1961, October 1965, November 1968, January 1973 and August 1987.

The only time the P/D ratio went substantially higher was in 1973 (prior to the worst bear market since the 1930s). At any rate, following those seven P/D ratio extremes, the average drop in the S&P was 41.2%, and this includes the drastic 86.2% collapse of 1929-32. However, even omitting the drastic 1929-32 example, the average drop in the other six instances was 33.6%. If the Dow was to experience a drop equal to the average of those six, we'd be talking about a Dow in the 2100-2200 area.

So again, based on price-to-dividends ratios, history tells us today's market is a dangerous one. Every time the P/D ratio for the S&P 500 moved into the 34-plus area, a drastic decline or a primary bear market resulted.

INVESTMENT POSITION: The bull still rules the box. But I guess the best way to start this section is to tell you to read and re-read the Value section. The secret, the thing that even your favorite broker won't tell you, is that stocks today are not just priced into the future, they're priced into the "beyond."



For all my new subscribers, I should add that in a bull market stocks advance until the market discounts the BEST that can be

seen ahead. Once the best is discounted and built into the price structure, there's no where to go but down. The down (bear market) phase may start slowly, it may start with high-level churning, it may start with a non-confirmation, but I can tell you one thing with certainty -- it always starts when hopes are high and when the stock market publications and the brokerage reports are bulging with exciting new "buy" suggestions

Suggestion: I've known Jim Benham for 18 years, and I've always found him to be honest, innovative and conservative. The Benham Group has just started a fund which holds only top-rated bonds issued by European governments. The new fund gives you a yield over 8.5% plus a position against the dollar. It's an excellent **diversification** and yield vehicle. **BUT** watch it for now -- the dollar is turning stronger and US bond yields are **RISING**. For more information call (800) FOR-SAFETY and ask for information on the Benham European Government Bond Fund.

Bush Gives Up Pretense of Balancing Budget in Future

Economy: Projection of continued deficits near \$200 billion may be the clearest sign yet that no serious deficit reduction effort will be made.

By JAMES RISEN
THE NEW YORK TIMES

In perhaps the clearest sign yet that the Bush Administration has all but abandoned serious deficit reduction efforts, a briefing on the annual economic report of the President, which was released Wednesday, even if Congress enacts all of President Bush's anti-recessionary economic proposals, the government will continue to suffer massive deficits of nearly \$200 billion a

year, more than it had predicted a year ago. Bushin told reporters that the White House decided to stop promising to balance the budget in some future year because Bush "wants to tell it the truth."

Political observers saw the announcement by the Administration as an important, yet troubling, watershed for American public policy. "Throughout history, one of the ways that empires have collapsed -- Spain, Holland, Britain, for example -- is through debt. There came a point in Britain, after World War II, in which the debt became something the country couldn't deal with, so it was no longer a political issue. We have reached that point in this country now."

ECONOMICS and COMMENTS: The Bush administration has finally turned honest -- well, at least in one sense. It no longer even makes a pretense of trying to balance the budget. Michael Boskin, Bush's chief economic advisor, practically said as much when, in a recent White House briefing, he said that even if Congress enacts all the anti-recession measures put forth by the administration, budget deficits of \$200 billion or more will be a fact of life as far out as 1997 (which is as far as the Administration calculates its spending).

Commented Washington's well-known political analyst Kevin Phillips, "Throughout history one of the ways that empires have collapsed -- Spain, Holland, Britain, for example -- is through debt. There came a point in Britain, after World War II, in which the debt became something the country couldn't deal with, so it was no longer a political issue. We have reached that point in this country now."

Up to recently, administrations have issued optimistic budget projections which, within a year or two, became more of a joke than anything else. Probably to sidestep such "jokes" (which, at this point, have ceased to be funny), the Bush Administration is giving up on deficit reduction predictions. That way, nobody can come back and bad-mouth the Bushies for projections that prove to be patently ridiculous.

So the problem of the towering deficits goes on. One fear, of course, is that somewhere ahead (under the sheer weight of new government debt issues) the bond market will collapse. That would send longer-term interest rates through the roof, and force the nation into a severe recession or worse.

Two weeks ago Bush's own Controller General, Charles Bowsher, was here in San Diego, and Bowsher made a point of telling his audience that interest on the federal debt, now over \$300 billion, was "eating us up." Bowsher added that until the 1980s "we owned our own debt," but now with 20% of our debt owned abroad "we're more vulnerable."

All of this seems to be lost on both Bush and the Congress, who together continue to spend an unconscionable 50% more than our Treasury takes in. Thus, federal debts and deficits are rocketing out of control, and the day of reckoning grows ever closer.

But will there be a day of reckoning? Count on it. Up to this point, the pain of the deficits has been limited to the area of a declining dollar and a lowered standard of living for Americans. The endless deficits plus the emphasis on consuming as opposed to research and development and investment is slowly (although it is now accelerating) moving the US into the classification of an "economic

basket case," a nation beset by crime, debts, homelessness, unemployment and downsizing industry. And so far, nobody in Washington has had the guts to come forth and tell the American people the full truth of the situation.

Of course, in their hearts Americans know the truth. But the national penchant continues to be a demand for entitlements and more entitlements -- without raising the money to pay for those entitlements. So when the economy staggers and election-time arrives, our President offers this solution -- more spending by Americans, more buying -- even to the point of reaching into retirement plans (IRAs) to dig up the extra money.

Meanwhile, the world watches and waits. And the international view is often worth heeding. This is from William Pfaff's column in the *International Herald Tribune* (Jan. 26). "A presidential race that produces so frantic and irresponsible a sacrifice of national interest to electoral advantage, so blatant a refusal to confront national responsibilities, puts the seal on America's tenure as world leader." Russell comment: Frightening words. But then, that's the way a goodly portion of the world is beginning to see the situation in America.

Last week I had lunch with two friends, one a surgeon and one a nuclear physicist. The physicist asked, "Russell, why are you so emotional about the American situation. What's the big emergency? What's so bad about America losing some power, maybe even becoming second or third in the world on the international power scale?"

A good question, I thought, and my answer was this. The United States has been the bastion of freedom and democracy ever since the mid-1700s. The Founding Fathers (at least many of them) held a strongly religious view regarding the new nation. You can see it plainly in the **Great Seal of the United States**, one side of which I show here (the Great Seal appears on every dollar bill). Unfortunately, not one in a thousand Americans have any inkling as to meaning of the symbols on the Great Seal.



Very, very briefly, I'll explain. The unfinished pyramid on the Seal signifies a great nation whose business and formation is unfinished. The number at the bottom of the pyramid is 1776, the year that the new nation was born. The words, "Annuat coeptis" translates to "He has prospered our undertaking." The meaning here is clear: those who designed the Great Seal believed that this nation was formed under Divine Guidance. The eye atop the pyramid again signifies God in the form of the "all-seeing eye." The implication is that God is watching over the new undertaking, the great new undertaking which was and is the United States.

The words, "Novus Ordo Seclorum" mean, "A mighty order of ages is born anew." Again, this refers to the birth and genius of the new nation. It's obvious that many of the Founding Fathers believed that the United States was destined to be a great nation, a world leader and an example and inspiration for all mankind.

As for me, I happen to take the Great Seal of the United States seriously. To me, the US is more than just a big democratic nation of 265 million people. The US has been, from its very beginning, the bearer of a concept. Since its founding the US has been the fount of liberty, a constant inspiration for the rest of the world, and a thorn (often a dagger) in the side of tyrants. Therefore, I don't want to see this nation sink into a cesspool of debt, crime, corruption, greed, government stupidity and presidential pussyfooting. Which is why I view what's happening in America today as more than just a series of assorted squiggles on the stock charts.

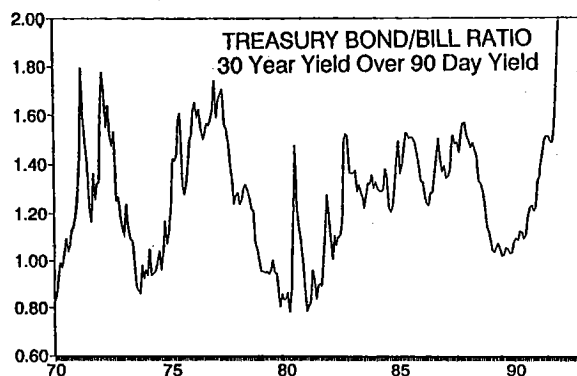
Frankly, I can't think of anything more ominous for my own children and for the rest of the world than the US sinking into the status of a second-class nation. If we do that, a great light in the world will dim. Consequently, I'll write about it, and I'll warn about it, as long as I have the strength to do so.

ASSORTED COMMENTS: The German steel workers just won a 6.4% wage increase, which is rather inflationary. On top of that, the German M-3 money supply is increasing at a year-to-year rate of 9.5%. These two items will probably prevent the widely hoped-for decline in German interest rates. Thus, the spread between US and German rates remains extraordinarily wide. Nevertheless, something else may be cooking. For whatever reason (and it's probably currently rising US long rates) the dollar is acting well. A move above 90 on the March Dollar Index would constitute a clear upside breakout.

Despite what the economists say, I wonder if the US isn't on the verge of rising inflation. The Fed has totally panicked, and adjusted reserves in the banking system are up 30% since November! The M-2 and M-3 money supply figures are rising, and selected commodities are perking up (as is the price of Japanese cars and US homes). Two commodities that are very sensitive to inflation and future industrial activity are copper (which is used widely in industry) and lumber (which is a staple in building). The lumber contract has rallied from its 1990 low of 183 to a recent high of 240, a sharp increase of 31%. Since January, copper has rallied from a low of 94.5 (May contract) to almost 100.

Responding to potential inflationary pressures, the March T-Bond contract has dropped from an early-January high of 105.5 to a recent low of 100.03. The bonds have clearly topped out, as has the confirming D-J Utility Average. Note: 100 on the March T-bond contract equals 8% for long rates, and we're about there now. Long rates are now well above where they were when the Fed dropped the discount rate a full 1% -- which must be driving the Fed up the wall.

The spread between long-term Treasury bonds and Treasury bills is now one of the widest in history. This chart shows the picture going back to 1970 (chart courtesy of *Logically Speaking*, 2509 E. Franklin St., Richmond, VA 23223). Why the huge spread between the long bond and the bills? Bill yields have been artificially forced down by the Fed. But the bond market is well aware of what's happening, and it is protecting itself -- against forthcoming inflation. Normally, in an era of record budget deficits and sub-standard saving rates, interest rates should be sky-high. But this administration has been willing to artificially push short rates down (and create new and even more outlandish deficits) in the hopes of jazzing up the economy prior to elections.



The problem: the new low rates are creating havoc among savers and particularly the elderly-retired of the US, who depend on higher interest rates for a great deal of their discretionary spending. *Sindlinger & Co.* reports that seven million households are helped by lower rates but 60 million households are hurt. Interest income, states *Sindlinger*, is running \$23.7 billion under last year's level. *Sindlinger* believes that today's low interest rates are killing retail sales. As for the rising long rates, if this continues, say good bye to any pick-up in home buying.

NOTES & QUOTES: From the Feb. 8 London *Economist*: "It has been 16 years since the American people last sent a Democrat to the White House. It has been even longer since they put Congress under Republican control. This divided government has frustrated all reform and encouraged profligate budgeting. It is not only in government that divisions must be healed. Three Republican administrations have left the country divided and confused. What prosperity they delivered was bought with borrowed money. Between 1980 and 1991 the national debt more than tripled. Many Americans did well as the economy grew, but millions were kept from prosperity. Two-fifths of all families emerged from the 1980s poorer than when they went in. The biggest sore on America's body politic, the abandonment of the inner cities, has led to an epidemic of drugs, crime, homelessness and dejection."

My wife, Faye, is a corporate lawyer, and she's been working late into the night on new biotech IPOs (initial public offerings). San Diego, by the way, is a hot-bed of biotech companies. Two years ago a new biotech company couldn't get financing. It's totally different today. Faye tells me that the financial printers, the companies that print the prospectuses, are so busy you literally can't find one that has the time to print up a new biotech prospectus. The little biotech companies are lining up to get public financing. And the public is lined up to buy their stocks. This is capitalism in all its glory. But mmm, let's not overdo it . . . This morning Faye arrived at her law firm at 6:15AM to meet an underwriter who was delivering a check for a new IPO offering. I called at 6:30 to find out if Faye had arrived safely. "Was it worth getting there that early?" I asked. "Yep," she replied, "The check I'm holding in my hand is for \$26 million."

From the Sunday *NY Times* (Feb. 2): "Call it George Bush's war on saving. Behind the State of the Union rhetoric about getting the economy moving again lurked what seems to be an important part of Mr. Bush's re-election strategy: Get Americans to stop saving for retirement and instead -- spend the money now."

There are currently 12 government agencies involved in intelligence or security policy, including the CIA, the National Security Agency, the Defense Intelligence Agency, and the Information Oversight Security Office. The cost of these agencies is not known, but the generally accepted figure for the CIA alone is over \$30 billion. Without a cold war, some wonder whether we need 12 (twelve) intelligence agencies, and a few feelers are out towards cutting the CIA in half and combining all security agencies into one.

Speaking of intelligence and information, it is now thought that the Labor Department has seriously underestimated the depth of this recession and missed total job losses in the nation by more than two million. Payroll tax filings for California indicate an extraordinary freefall in jobs late in 1990 and in 1991. According to those records, the Golden State has suffered its worst job losses in half a century, and according to state officials the US government has underestimated losses in California by more than 500,000. States Ted Gibson, chief economist for Department of Finance in Sacramento, "To me it's very obvious that the recession is far, far deeper than the Labor Dept. figures are indicating." The fact is that since the recession started, California has lost 660,000 jobs. Says the *LA Times*, "There hasn't been such a staggering drop -- 5% of the entire job total -- since 1938." Russell comment: This goes a long way towards explaining why the American public has been so pessimistic about the economy.

When people feel threatened, they often turn their fear into humor. That being the case, here are a few Japanese funnies: Did you hear about the new sushi bar catering specifically to lawyers -- Sosumi. Next, did you hear about the Japanese Psychiatric College -- Wasa Mara U.

Crime is growing out of all proportions in the US. Well meaning citizens continue to call for super-strict gun laws, and I disagree. I feel that armed citizens who know how to protect themselves constitute a deterrent to crime. The bad guys can get guns anytime,

anywhere. So why disarm decent citizens? In interviews with criminals, they all say that the last thing they want is to break into a house and be confronted by an owner with a Colt .45 staring them in the face. State licensing and reporting requirements vary from state to state, so the best measure of gun sales is via manufacturing records. Hand gun production in the US (forgetting huge foreign sales) increased 19% between 1985 and 1990, to more than 1.8 million guns a year. Item: Do strict gun laws work? NYC and Washington D.C. have the nation's strictest handgun laws. Washington has the highest per capita murder rate in the nation, and NYC is right up there.

A new book by former Social Security Commissioner (1986-89) Dorcas Hardy tells us not to count on SS for our retirement. Writes Hardy, "Most of us like to think money will be there for us when we retire, but unless changes are made, the benefits we're expecting won't be there -- as early as 2010." She continues: "The US Treasury plays a shell game, borrowing money from Social Security to fund normal government operations. The money is backed by IOUs and nothing else. In 2010, when the SS systems needs to tap its reserves, there will be nothing there. Of course, the government would never stop making some kind of payments. But where is it going to get the money?" Social Security is the biggest item in the budget. It pays out \$300 billion a year or \$32 million an hour. So as for Social Security, says Hardy, "I would eliminate it entirely."

The big "Expo '92" world's fair is coming up in Seville, Spain. Here's how the *NY Times* describes the US entry: "Come April visitors will find that the US pavilion consists of two hand-me-down geodesic domes. A restaurant featuring American food is operated by a Canadian company." The *Times* adds, "In a scathing New Republic article, John Judis contends that the Americans will be outshone by Japan, New Zealand, Saudi Arabia, Hungary, Canada, Puerto Rico, and all major European states."

I continue to be amazed by the news coming out of booming Singapore. With a population of only 3 million, Singapore imports and exports with the rest of the world last year totaled \$137 billion. In 1990 the port handled 188 million tons of cargo, the largest tonnage in the world. Singapore is growing so fast that some feel it will eventually surpass Hong Kong as the top trade center of the South China Sea.

More than 2,000 people across the nation have written to the Texas comptroller's office asking for George Bush-style residency in Texas (which has no state tax). Bush has a home in Maine, but rents a hotel room in Houston to claim Texas residency. So when Bush claimed, "Read my lips, no new taxes," he was probably referring to himself.

A few years ago Ford bought Jaguar motor car company for almost \$3 billion. At the time, I wrote that that price for the antiquated Jaguar company was idiotic. Last year Jaguar lost roughly \$350 million. Quite an investment for Ford. Speaking of autos, note that GM is doubling to \$1.5 billion the size of its new convertible preferred stock issue, while Chrysler is boosting the size of its planned private offering of convertible preferred from \$400 million to \$1 billion. It's called watering your stock, or grabbing for the cash while the grabbing is good. No, I won't be a buyer of either issue.

One reason Americans don't save is that they are too busy paying off debt and particularly mortgages. The Bush idea of a \$5,000 credit for first time home buyers is hardly going to boost US savings. The fact is that most Americans can't afford a "first house," but that doesn't stop them -- they go heavily into debt as soon as they can scrape together the downpayment. Me, I'm old-fashioned. I didn't buy a house until I was in my 40s, and then I did it for cash, all cash. With due respects to the banks, I hate debt, and I never met a mortgage I didn't dislike (actually, I think mortgages only make sense during times of rampant inflation).

I asked my eleven-year-old daughter, Lauren, to name some of the girls in her class. Savor these names: Allegra, Tara, Lea, Nicole, Bethea, Lindsey. What ever happened to the old names: Gertrude,

Hortense (my mother's name), Mable, Florence, Pearl, Beatrice? For the most they've been dropped. Why? Just not pretty enough.

The new hot novel is Michael Chriton's "Rising Sun," about a murder and the near-nightmare world of Japanese influence peddling and espionage. Chriton's book has the right timing, and he uses his characters to express his attitude towards Japan. Listen: "If you sell the country to Japan, then they will own it. And people who own things do what they want with them." Again, they think anyone who's not Japanese is a "stinking, vulgar, stupid barbarian." And again, in Japan "every criminal gets caught, and the conviction rate is 99%. Trains are on time, bags are not lost, connections are not missed, and deadlines are met."

Last year 24,000 Americans were murdered (these are the reported cases). How many is that? It's more than all the US Marines killed in the combined battlefields of WWI and II.

The *WSJ* did a study of the "good governors" and the "bad," based on their handling of fiscal policy. Best were Weld of MA and Sullivan of WY, both with A ratings. Next best were Engler of MI, Walters of OK, Wilder of VA, and Bayh of IN, all with B ratings. Worst (all received Fs) were Caperton of WV, Miller of NV, Wilson of CA, Weicker of CT, Florio of NJ, and Waihee (the very worst) of HI. Of California, the article states, "Pete Wilson has had a dreadful first year. To close a mythical \$14 billion budget deficit, Wilson supported a \$7 billion tax hike, the largest state tax increase in US history, shattering the previous record of less than \$3 billion. The tax package lifted California's income tax rates to 11%, a change that has already contributed to an exodus of business from the state. Wilson said that he signed the gigantic tax package in exchange for \$7 billion in budget cuts. In fact, total spending in California will rise by \$6 billion in 1992, a 10% rise." Russell comment: and on top of all this, there will be a \$2 to \$6 billion budget deficit this year. As I've said before, you've got to really love this state to live here. If you care anything about your finances, you'll move. By the way, Cuomo of NY gets a C rating, and he's still struggling with big deficits and a major forthcoming tax package.

How's this for a bid/ask spread? A seat on the NYSE sold two weeks ago for \$600,000, up \$125,000 from the last seat which was sold on January 16. Current bid for a seat is \$400,000; current asking price is \$800,000.

Want to invest in what could be a hot and super-controversial movie? Spike Lee is looking for an investor to cover an extra \$5 million that the movie "Malcolm X" will cost. The company that holds the completion bond on this movie just took it over because Spike is going well over his budget of \$28 million (the Lee company is already \$5 million over budget). When a production company goes over budget, the bonding company can take over, which is what the Completion Bond Co. has done. But Spike says he's willing to give up some participation if an investor will come in and make up the shortfall. And that's Hollywood.

Statistics: The US government now owns an unbelievable \$120 billion worth of low-grade property, much of which, it seems, can't be sold at anything like reasonable prices. . . . The average car or truck payment climbed to a record \$310.26 last year, up 7% from 1990's \$290.36. Stanford just raised its tuition and board 7.5% to \$22,850. Median price of a home is up 7% over a year ago. There's no inflation? I figure the US could add \$1 trillion to the federal debt in the next two years. That's right, I said one trillion dollars.

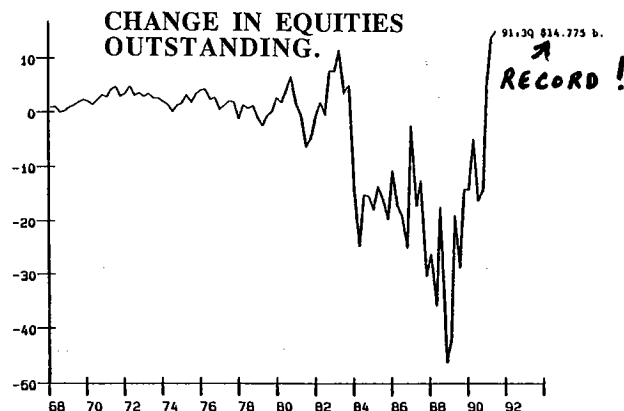
Ah, real estate. The DeBartolo empire is under pressure, according to the *WSJ* (Feb. 11). The DeBartolos have over \$4 billion in debt, and they are now "downsizing." They also own football's '49ers, and this franchise could also be for sale. In Britain, the Reichmans (Olympia & York) are also being squeezed, and their monster Canary Wharf development in London is putting up office buildings for sale.

Ouch Dept: The IRS has mounted an aggressive effort to tax a portion of reserves that have been built up by co-op boards. If the agency wins on this (it's in the courts now), it would stick co-ops with millions of dollars of current and back taxes, not to mention penalties.

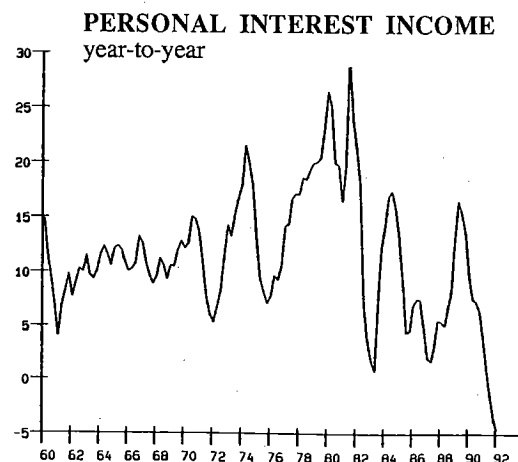
Lawyers, bankers and accountants are getting ready to take on the Macy's Chapter 11. The insider thinking is that this will be one of the longest, most complex and most expensive bankruptcies in history.

Despite what you may have read or heard, the European economies are slowing down with many European nations at or near recession levels. This is going to impact on US exports. Even Germany, the economic engine of Europe, is slowing down. But German interest rates remain high, and because the G-7 nations tie their currencies to the Deutsche mark, the G-7 nations' rates remain high too. The high rates are impacting on the G-7 countries, but Germany (which is mortally afraid of inflation) will not bring its rates down.

Ed Hyman's (*International Strategy and Investment*) chart shows the change in US equities outstanding from 1968 to the present. Following the '84-'89 plunge, there has been a massive issuance of new equity -- to the current record. When the public wants stocks, Wall Street will oblige (just as it supplied debt in the form of junk bonds and junk financing during the 1980s).



Hyman's chart shows what's happened to personal interest income in the US (year-to-year basis). Thus, the collapse in interest rates has collapsed interest income for Americans (particularly older Americans) and murdered discretionary spending.



For whatever reason, Americans still can't seem to save. Ed Hyman's chart of the US savings rate tells the story -- the latest savings rate is down to a mere 4.7% (and, of course, Mr. Bush would like to bring it down even further).

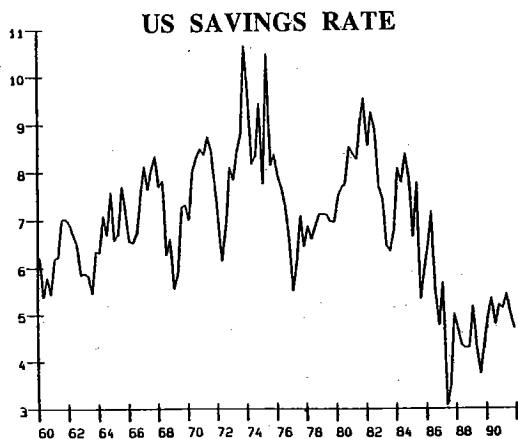
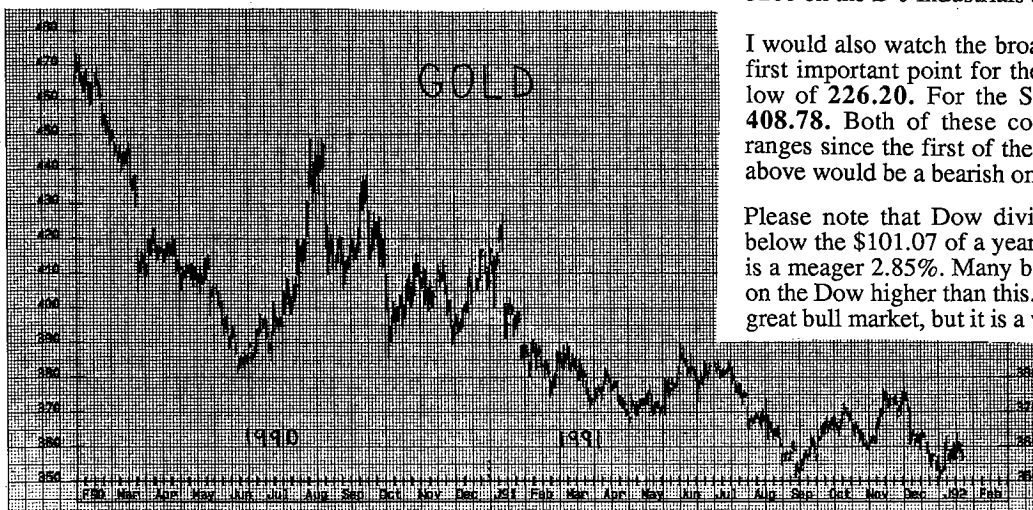


CHART BOOKS: Again, I want to remind subscribers that the new pages (1991) for the chart books are in. I'm referring to the chart books for the **D-J Averages** and the **A-D ratio**. If you do not know about these two valuable albums, drop a line, and I will be glad to send you a descriptive circular. Subscribers who want to up-date their albums please send \$3 each for the new 1991 pages or \$3 for each back-year page that you need. Thank you.

COPS: I want to say a bit more about bonds. Bonds have become the "policemen of the economy." The reason is that today's bond buyers and bond holders have become much more sophisticated about the economy, and if there's one thing that scares the devil out of a bond holder, it's inflation. The reason that bonds (and I'm talking about long-term bonds, particularly Treasury bonds) are the policemen is that the long-term bond market is one area of the economy that the Federal Reserve cannot control.

Thus, today we see the remarkable sight of the T-bond contract "falling out of bed" on February 13, bringing the March T-bond down below 100. At this level, the yield on the "long bond" rises to 8%. What's happened is that bond buyers just don't like what they see. And what do they see? They see a President who states that he will "do whatever it takes" to get re-elected. The bond market sees a Fed that is panicking and flooding the system with reserves, while bringing short rates down to the lowest level in over two decades. The bond market sees sundry basic industrial prices moving up. The bond market sees a profligate government running up federal deficits of over \$1 billion a day. And the bond market sees a federal deficit of probably half a trillion dollars this year plus another half trillion next year (that's right, trillion not billion).

At 8% on the long bond, mortgage rates will move up, auto financing costs will move up, and the whole long end of interest rates spectrum will move up. All this while the country is not yet out of recession. And the bond market asks, "Where will interest rates be if the economy really starts picking up?"



So as I see it, the bond market has become the strong arm, the policeman of the US economy. And in moving back into the 8% range, the Treasury bonds are saying that they don't like what Mr. Bush is proposing, they don't like what Congress may do, and they don't like the Federal Reserve's actions. You've got to admit - it's an interesting picture.

GOLD: The chart below (courtesy of *Prudential Securities*) traces the daily gold action from 1990 to the present. The long downtrend is obvious, but note the "double bottom," at the 350 level. That's where there seems to be major support, probably from both investors and the central banks.

Technically the picture for gold is clear. Basis the April contract, gold has to close above 365 for a bullish designation. In the meantime, I'd classify gold as neutral -- a metal in search of a trend.

LATE NOTES: On the political front I don't think I've ever seen a president so anguished, so angry, so manipulative, so intent on keeping his job. Bush's "plans" for the economy are so obviously just little gifts for all the voters that even the Republicans have to be embarrassed.

The best thing going for Bush is the lightweight caliber of his Democratic opponents. The best thing going for the Democrats is George Bush himself, plus the sticky unemployment figures and the recession that won't go away. Who's having fun with the 1992 campaign? So far, it's the cartoonists and editorial writers.

The Democrats' new tax plan is for minor tax relief for the "middle class," a boost in the top tax rate to 35% and a 10% "surcharge for millionaires." Brilliant. When you survey the whole picture you can see why we've had nothing but Republican presidents and Democratic congresses. Congress (hopefully) keeps the presidents' damn fool ideas from becoming law. And the president (hopefully) vetoes the damn fool bills that the Congress comes up with. In the meantime, will Mario Cuomo be drafted? If drafted, will he serve? Will Saddam Hussein be toppled before election time? Will the recession lift?

The Dow made a new record high on February 12. But in the face of numerous non-confirmations, the market turned down the next day, which was February 13. The really bearish feature of February 13 was the big drop in the long bond.

It seems certain now that any improvement in the US economy will simply set off additional pressure in the bond market, and declining bonds mean higher rates. Frankly, I don't know how the Fed or the Congress or the Administration are going to get around this. With mountains of debt still built into this economy, the last thing in the world it needs is a trend to higher interest rates.

If there is to be trouble, it will be signaled initially by a break in the Averages. On the downside the first important levels to watch are 3200 on the D-J Industrials and 1330 on the Transports.

I would also watch the broader composites. On the downside the first important point for the NYSE Composite is the January 31 low of 226.20. For the S&P 500 it is the January 31 low of 408.78. Both of these composites have been in tight trading ranges since the first of the year, so a breaking of the lows listed above would be a bearish omen.

Please note that Dow dividends are now down to \$92.41, far below the \$101.07 of a year ago. At \$92.41, the yield on the Dow is a meager 2.85%. Many bear markets have begun with the yield on the Dow higher than this. So 2.85% may not spell the end of the great bull market, but it is a warning that must be heeded.

NEXT MAILING:

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